

time of the appraisal date for the properties involved in this appeal (January 1, 2005), most of the units in the Trakker Building were still under construction, although the particular units involved in this appeal were completed.

This Board modifies the decision of the Gallatin County Tax Appeal Board. For tax year 2005 the DOR cost method of valuing the Trakker Building and these specific units is confirmed; however, for tax year 2006 and subsequent, as the building is completed and the character of the individual units is established, the DOR should be able to use the more conventional approaches to valuation, such as the income and sales-comparison methods.

FACTUAL BACKGROUND

1. Due, proper, and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.
2. The subject property is described as follows:

The subject properties are two commercial condominium units within the mixed-use condominium building known as the Trakker Building and located within a recently-annexed portion of the City of Bozeman known as Baxter Meadows Subdivision.

3. For tax year 2005, the Department of Revenue appraised the two units (each a warehouse and office) as follows: Unit 1-A/AW--- \$45,620 land and \$530,720 improvements for a combined value of \$576,340; and Unit 1-B/BW--- \$54,890 land and \$638,570 improvements for a combined value of \$693,460. The total appraised value by DOR for the two units involved in this appeal is \$1,269,800. In this appeal only the value of the improvements is at issue. Taxpayer has accepted DOR's appraisal and allocation of the land values for these units.
4. According to DOR Commercial Appraiser Mark Olson, the unit values were achieved by first valuing the entire 12-unit Trakker Building and then allocating that value to the individual units, two of which are the subjects of this appeal. The method of allocating the entire value was based on the formula established in the Condominium Declaration for sharing the common elements of the condominium and, in this instance, each unit bore a certain percentage based upon the net square feet of their unit compared to the total square footage for the entire building.
5. The taxpayer filed an AB-26 review request with DOR.

The parties met and attempted to resolve their differences, but were ultimately unsuccessful.

6. Taxpayer initiated an appeal to the Gallatin County Tax Appeal Board. For its valuation of the two units the Taxpayer relied upon a fee appraisal conducted by Mr. Kraig Kosena, MAI, of the firm of Kembel, Kosena, & Company, Inc. with a "date of value" of April 9, 2003. (State's Exhibit A). Since the facility was not then constructed, Mr. Kosena used the architectural drawings for the purpose of determining the size and intended use of each of the units, and then looked to existing properties in the Bozeman market for relevant valuation data. For the entire Trakker Building (12 units) Mr. Kosena came up with a value indication of \$2.2 million with primary reliance placed upon the income approach to value (imputed office rents of \$12 per square foot and warehouse rents of \$6 per square foot, together with a capitalization rate of 9.5%). Mr. Kosena did not value any of the units as residential units because they were not shown as residential units in the architectural plans.

7. At a later point, Mr. Kosena was asked to use his previous appraisal to indicate the value of the 6 units (including the two on appeal here) that were purchased by BSD Financial. In a letter dated July 16, 2003 (State's Exhibit A) Mr. Kosena valued the purchased units at \$1,380,000 upon completion, based upon market indications of comparable sales of commercial property selling for \$90 per square foot for finished office space, and \$65 per square foot for finished warehouse space. When those values are applied to the properties involved in the appeal, they provide a value of \$959,045 (8557 square feet of warehouse space at \$65 a square foot and 4476 square feet of office space and proportionate share of common elements valued at \$90 per square foot).

8. The Gallatin County Tax Appeal Board, after holding a hearing and taking testimony, determined the appropriate values for the subject properties are as follows: Unit 1-A/AW ----\$504,351, and Unit 1-B/BW----\$606,848; for a total value of \$1,111,199. CTAB apparently based their determination of value primarily

upon the taxpayer's purchase price of the 6 units, which were purchased in August of 2004 for \$1,275,281.

9. From such decision, the Department of Revenue prosecuted this appeal.

DOR'S CONTENTIONS

DOR contends that Montana law and administrative regulation require it to use the methodology of appraisal that it used in this instance. Section 15-8-111(4) first provides that the DOR should appraise residential condominium units based upon the comparable sales method of appraisal. It then instructs the DOR to use the income approach to value, specifically the capitalization-of-net-income approach, to value commercial condominium units.

The statute then states that "if sufficient, relevant information on comparable sales is not available for residential condominiums, or if sufficient, relevant information is not made available for commercial condominium units, the department shall value condominiums using the construction-cost method." Section 15-8-111(4)(c), MCA.

DOR contends that it is required by Montana law and administrative regulation to value a condominium unit in the manner in which they did here; that is, first value the

entire condominium as a whole using construction costs derived from published manuals; then allocate back to each individual unit its proportionate share based on the apportionment provided in the condominium declaration. The share is not based on the market value of the unit but on the allocation provided in the condominium declaration for sharing the common elements. Section 15-8-111(4), MCA.

Section 15-8-111(4), in sub (a) and (b), directs DOR to appraise residential condominiums by using the comparable-sales method of valuation, and directs DOR to appraise commercial condominiums using the capitalization-of-net-income approach to valuation. Mark Olson, commercial appraiser for DOR, testified that he could not do a capitalization-of-net-income approach for the units on appeal because the entire building was not finished, so he could not obtain adequate net income calculations. He also stated that with several of the units unfinished, constituting only a "shell", it was not clear whether they should be valued as office space, residential, or even storage space. He stated that even if he had income information from some of the units it would not be sufficient since he had to value the entire condominium

building.

The "default" provision of the statute where income information is not available is contained in subsection (c) of 15-8-111(4),MCA, and states that where "relevant information on income" is not available, the Department should use the construction cost method of valuation in order to value the entire condominium structure and then allocate value back to each unit in accordance with the method for sharing the common elements provided in the condominium declaration. In this case the condominium declaration, contained in State's Exhibit 4, provides for an allocation for the "common elements" based on the number of net square feet in each unit expressed as a percentage of the square footage in the entire structure.

DOR Commercial Appraiser Mark Olson acknowledged that this method could produce some anomalous valuation results, since the resulting values for each individual unit are not based on market data but solely upon the apportionment method that is provided in the condominium declaration.

DOR also points out that Section 15-8-111(3)(c) relieves the department from setting its appraisal to market value where condominium property is concerned.

Commercial Appraiser Mark Olson acknowledged that the values for the subject properties were probably not an accurate reflection of market values, but that he was required to follow Montana law and administrative regulation for the valuation of condominium properties.

TAXPAYER'S CONTENTIONS

BSD Financial, the taxpayer in this case, asserts that the two units in question on this appeal, both warehouse units with small offices attached to them, are overvalued based upon similar properties in the Bozeman market. They primarily rely upon the fee appraisal conducted by Kembel, Kosena & Co, Inc. with a date of value of April 9, 2003.

The initial fee appraisal valued the entire 12-unit Trakker Building while a later letter broke out the value for the six units that were purchased by BSD Financial.(State's Exhibit A). That letter, dated July 16, 2003, valued taxpayer's six units at \$1,380,000 upon full completion as commercial units including storage, retail and office uses. At the time of the initial fee appraisal, and again at the date of the letter concerning the BSD Financial units, the building was under construction and

only the subject units were completed.

Taxpayers completed their purchase of the six units of the Trakker Building, including the subject units, in August of 2004 for a purchase price of \$1,275,281. Appraiser Kraig Kosena updated his values from the previous appraisal in a letter dated July, 29, 2004 (State's Exhibit B). Since only the two subject units were completely finished, he reduced the value of the other four commercial units by 40% and reduced the value of the taxpayer's share of the common elements by 10% due to their incompleteness. The resulting appraisal value, with these reductions applied, was \$1,261,722, which supports the value of taxpayer's purchase price for the units.

While Mr. Kosena, the fee appraiser, did not break out values for the subject properties, it is quite easy to do so based on the values he derived. In the letter dated July 16, 2003 (Ex. A) Mr. Kosena states that, based on the analysis found in the full appraisal and primarily relying on the sales of similar commercial property in the Bozeman area, he finds the appropriate amounts for valuing the subject units as \$65 per square foot for warehouse space and \$90 per square foot for other commercial space as well

as the common areas of the condominium. As applied to these units the values would be as follows:

Finished warehouse
Unit A/W 3925 s.f.
Unit B/W 4632 s.f.
8557 s.f. @ \$65 s.ft.....\$556,205

Finished office area for warehouse
Unit 1-A 1354 s.f.
Unit 2-A 1719 s.f.
3073 s.f. @ \$90 s. ft....\$276,570

Allocated percentage of common areas
47.81% of 2934 s.ft....1403 s.ft
1403 s.f. @ \$90 s. ft....\$126,270

Total value of subject properties...\$959,045

At the hearing in this matter the taxpayer indicated they could accept the value of the units established by the Gallatin County Tax Appeal Board. The local board valued the two units at a combined value of \$1,111,199.

BOARD'S DISCUSSION

DOR, through appraiser Mark Olson, acknowledges that the valuation method used to value the two units that are the subject of this appeal may not reflect a true market value. He asserts, however, that DOR has no choice but to follow the methodology for valuing condominium properties that is set forth in subsection (4) of Section 15-11-118,

MCA.

As was discussed in the summary of DOR's position, Section 15-8-111, MCA, allows the department to use cost as a valuation method when it does not have "sufficient, relevant information" to use either sales comparison data in the case of residential condominiums or capitalization-of-net-income data in the case of commercial condominiums.

In using a cost approach to value condominiums the difficulty is how to "break out" the common elements of the condominium, such as land, foundation for the building, hallways, parking lots, etc. from the individual units. The solution provided in subsection (4) of Section 15-8-111, MCA, and as adopted by the 2005 Montana Legislature, is to value the entire condominium project (land, building, and all common elements) and then allocate that value back to the individual units according to the formula provided in the condominium declaration for sharing the common elements. The typical way that is done in a Condominium Declaration is to determine what proportion of the total square footage in the project is represented by each individual unit. The resulting percentage becomes the share of the common elements held by that unit, and is used to apportion the

expenses for the upkeep and maintenance of the property. (Montana law allows for other methods of sharing the expenses and maintenance of a condominium; however, the method that is used here is the one typically used in Condominium Declarations.)

As noted, the Montana Legislature recently decided that the method for apportioning the common elements of the condominium building in the Condominium Declaration should also be the way to apportion value when the cost method is used to value the property for property tax purposes. Section 15-8-111(4), MCA.

The statute seems to contemplate that the condominium involved will be all of a similar character. That is, the condominium will involve exclusively residential units; or, that the condominium will involve exclusively commercial units. When the condominium units are all of the same character, it is likely that an allocation of the value of the entire structure based on the net square footage of each individual unit will be a fair approximation of market value.

The problem arises where, as here, the condominium project is a so-called mixed-use condominium, containing

residential units as well as several varieties of commercial units: warehouse storage, retail, and office space. In such a project there can be a wide variance in values per square foot ranging from the low-value warehouse space to high-value luxury residential.

At the time of the DOR appraisal in February of 2005 there were only three finished units in the Trakker Building. Two of the units were owned by the taxpayer and are the warehouse/small office units that are the subject of this appeal. The warehouse portion of these units was valued by the fee appraiser based on Bozeman-area market data at a rate of \$65 per square foot. The only other completed unit in the Trakker Building was a luxury residential unit that was not owned by the taxpayer. This unit was one of the smallest in the building but had been finished to the highest standards as a residential condominium, and was being marketed for a price that represented \$297 per square foot. (See State's Exhibit E from CTAB hearing).

The statutory methodology employed by DOR in this mixed-use condominium leads to a result that is at odds with fair market valuation: both the luxury residential unit and the warehouse/small office units in the mixed-use

condominium project were appraised by DOR at very similar costs per square foot. (See exhibit "E" of CTAB hearing— between \$107 and \$109 per square foot).

As applied to a mixed-use condominium project it is apparent that the method used by DOR, and taken from statute, leads to a result that is not a close approximation to fair market value.

Accordingly, we think that this methodology should be used as little as possible for valuing condominium property, particularly when the condominium property is of a mixed-use character. We should also not lose sight of the fact that the statute in question (Section 15-11-118(4), MCA) starts with a preference for using sales-comparison data for residential condominiums and income data for commercial condominiums. While it may take some digging to come up with "substantial, relevant data" (per the statute), this should not be that difficult in an active market such as Bozeman and Gallatin County.

However, due to the fact that only three of the twelve units of the Trakker Building were completed at the "date of value" of January 1, 2005, we agree that the use of the cost method as applied by DOR was appropriate during the

construction phase of the Trakker Building and before the character of several of the units had been established. However, once the units have been built out and their character as office, retail, warehouse, or residential has been established, the DOR should shift towards the preferred method of valuation as indicated in the statute; namely, the sales-comparison approach for any residential units and an income-approach for any of the commercial units.

RELEVANT LAW

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-301, MCA.
2. Section 15-8-111 MCA. Assessment - market value standard - exceptions. (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.
3. Section 15-8-111 MCA. Assessment - market value standard - exceptions. (4) (c) If sufficient, relevant information on comparable sales is not available for residential condominium units or if sufficient, relevant information is not made available for commercial condominium units, the department shall value condominiums using the construction-cost method.

When using the construction-cost method, the department shall determine the value of the entire condominium project and allocate a percentage of the total value to each individual unit. The allocation is equal to the percentage of undivided interest in the common elements for the unit as expressed in the declaration made pursuant to 70-23-403, regardless of whether the percentage expressed in the declaration conforms to market value.

4. The appeal by the Department of Revenue asking to overturn the decision of the Gallatin County Tax Appeal Board is granted and the original values established by the DOR for tax year 2005 for these units is approved; namely, the land and improvement known as Unit 1-A/AW of the Trakker Building is appraised at \$576,340, and the land and improvement known as Unit 1-B/BW is appraised at \$693,460.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the decision of the Gallatin County Tax Appeal Board is modified and the valuation by the Department of Revenue for the subject properties for tax year 2005 is affirmed.

Dated this 18th day of September, 2006.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

// _____
JOE R. ROBERTS, Member

// _____
SUE BARTLETT, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 18th day of September, 2006, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

BSD Financial Group, LLC
Attn.: Sven M. and Denise A. Ahlberg
3701 Trakker Trail
Bozeman, Montana 59715

Office of Legal Affairs
Department of Revenue
Mitchell Building
Helena, MT 59620

Ms. Dorothy Thompson
Property Tax Assessment
Department of Revenue
Mitchell Building
Helena, Montana 59620

Gallatin County Appraisal Office
2273 Boot Hill Court, Suite 100
Bozeman, MT 59715-7149

Mr. Phil Olson, Chairman
Gallatin County Tax Appeal Board
P.O. Box 545
Manhattan, Montana 59741

DONNA EUBANK
Paralegal